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E.O. 12958: N/A
TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER
SEPTEMBER 30 2005 ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Consumer Price Inflation Close to Market Expectations;
- Producer Prices Show Oil Price Impacts;
- Second Quarter 2005 Formal Employment Gains;
- GDP May be Underestimated;
- Second Quarter GDP Growth Rebounds;
- South Africa Slips One Spot in Global Competitiveness Report; and
- Oil Prices and Rand Impact Inflation Target.

End Summary.

CONSUMER INFLATION CLOSE TO MARKET EXPECTATIONS
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¶2. August consumer price inflation increased close to the market consensus forecast and most analysts expect that interest rates will remain unchanged throughout the rest of 2005. Higher fuel prices drove August targeted inflation rate (consumer prices excluding mortgage costs, CPIX) to 4.8% from July's 4.2%. Consumer prices (CPI) increased 3.9% from July's 3.4%. Market consensus expected CPIX and CPI to increase by 4.9% and 4%, respectively. Oil prices remain a significant risk to the inflation outlook and inflation is expected to trend higher in coming months to end 2005 at about 5%. The single largest contributor to August consumer inflation remained transport, which rose 1.9%. Fuel prices, which rose 27 rand cents a liter in August, rose by another 29 rand cents a liter in September. Food prices declined to 2.6% year on year last month, after a sharp rise to 2.8% in July. August's consumer inflation figures did not provide conclusive evidence that high fuel costs were spreading to the rest of the economy, though at some point higher oil prices would drive up prices of other products such as food and other consumables. Economists expected that the CPIX would increase above 5% in September because of oil prices. Source: Business Day, Business Report, September 29; Investec CPIX Update, September 28.

¶3. Comment. On September 28, Finance Minister Trevor Manuel said that he did not have serious concerns about the effect of oil prices on economic growth or the balance of payments. End Comment.

PRODUCER PRICES SHOW OIL PRICE IMPACTS

¶4. August producer prices (PPI) increased by 4.2%, up from 3.6% in July, with petroleum and coal products showing the largest increase. August's PPI inflation matched market consensus forecasts at 4.2%. Domestic producer prices increased by 3.6% and imported producer prices increased 6.2% compared to July's increase of 3% and 5.2%, respectively. With the exception of petroleum and coal prices, other industries showed relatively mild monthly price gains, another signal that higher oil prices have not yet significantly affected domestic industries that use energy. Besides July and August 2005, the last time that monthly producer price inflation had been above 3% was in April 2003. Over the past 5 years, producer prices increased 0.6% in 2004, 1.7% in 2003, 14.2% in 2002, 8.4% in 2001, and 9.2% in 2000. Source: Standard Bank, PPI Alert; I-Net, September 29.

SECOND QUARTER 2005 FORMAL EMPLOYMENT GAINS

¶5. Statistics South Africa's (StatsSA) second release of the Quarterly Employment Survey (QES) showed the total number of employed people in the formal non-agricultural sector increased by 131,000 in the second quarter of 2005, increasing 1.9%. During the previous quarter, the number of jobs created declined by 2.1%. Just over 7 million people were employed by the formal non-agricultural sector

during the second quarter. Construction was the main employment generator creating 46,000 jobs, followed by the wholesale and retail trade sector, which created 29,000 jobs. In manufacturing, the number of jobs rose by 14,000, or 1.2%. Apart from the electricity, gas and water supply industries, which were unchanged, all the sectors surveyed showed growth. GDP increased 4.8% in the second quarter, from 3.5% in the first, with manufacturing and construction industries posting strong growth. Source: Business Day and Business Report, September 28.

¶6. Comment. As of June 2005, the QES replaced the Survey of Employment and Earnings, which did not include employment in small companies. QES statistics are not strictly comparable with those in Stats SA's biannual Labor Force Survey which provides the official jobless rate, and give a good indication of the economy's job-creating performance. The QES is derived from a survey of almost 24,500 businesses registered to pay income tax, excluding those in the agriculture, hunting, forestry and fishing sectors, while the Labor Force Survey involves interviews with 30,000 households. End comment.

GDP MAY BE UNDERESTIMATED

¶7. Efficient tax collection by the South African Revenue Service (SARS) was not enough to explain the strong increase in Value Added Tax (VAT) receipts over the last three years, resulting in the possibility that GDP could be underestimated, according to Iraj Abedian, CEO of the Pan-African Investment and Research Services. VAT receipts have grown faster than GDP, suggesting that consumption patterns have changed. South African Reserve Bank figures showed high revenue collection in the first quarter, with the government set to overrun its R369.9 billion ($60 billion, using 6.3 rands per dollar) revenue target. SARS collected about R90.2 billion ($14 billion) in the first quarter of the 2005/06 fiscal year, a yearly increase of 19.6%. Abedian asserted the strong growth in VAT revenue was partly explained by efficient tax collection and an underestimation of the size of the economy, but also by a shift in consumer spending patterns. VAT receipts increased due to a switch from zero-rated basic food products, such as fruit, vegetables, brown bread and milk, to products such as fruit salad, processed vegetables and white bread, which were taxed at 14%. A 10% shift in spending towards taxable food substitutes resulted in VAT revenue rising nearly 5%. To explain the current growth in VAT revenue, Abedian said that expenditure should have shifted towards taxable products by as much as 30%, leading to suspicions concerning accurate coverage in national income and product accounts. Source: Business Report, September 26.

SECOND QUARTER GDP GROWTH REBOUNDS

¶8. The latest Quarterly Bulletin (September 2005) from the South African Reserve Bank presented a strong domestic economy supported second quarter 2005 GDP growth of 4.8%, up from first quarter growth of 3.5%. Real domestic demand (excluding the foreign sector), in its 18th quarter of positive growth, grew 4.9% in the second quarter 2005 compared to 1.7% during the previous quarter. Household consumer spending increased 5.9% from 5.5% in the first quarter. Demand for durable goods led consumer spending. Real spending on durable goods increased from 12% in the first quarter to 26.5% in the second, reflecting high consumer confidence levels, low interest rates and attractive sales incentives. Household disposable income rose by 5.7% during the second quarter. Increased credit financed consumer spending, with the household debt to disposable income ratio reaching 61.8% in the second quarter in comparison to 51.4% six quarters earlier. Investment spending slowed in the second quarter, increasing 5.7% from 10.1% in the previous quarter. In the first quarter, public corporation investment was boosted by South African Airlines' purchases of aircraft. Gross saving as a percentage of GDP increased to 13.5% in the second quarter from 13% in the first. South Africa's savings rate is low compared with other emerging markets, such as China, which has a savings rate of 50% of GDP. The current account improved due to an increase in exports. The current account deficit reached R51 billion in the second quarter, or 3.4% of GDP from first quarter's 3.8% of GDP. Source: Business Day and Business Report, September 23.

SOUTH AFRICA SLIPS ONE PLACE IN GLOBAL COMPETITIVENESS REPORT
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¶9. In the World Economic Forum's (WEF) 2005 Global Competitiveness Report, South Africa slipped one place to 42 out of 117 countries compared with last year's ranking of 41. The WEF report praised South Africa's strong macroeconomic policies; however, pointed to rising crime,

corruption and inability to adopt new information technologies as reasons for the 2005 slippage in rankings. Indicators showing access in South Africa to computers and the internet and university enrollment rates declined, while 20% of the forum's survey thought that an inadequately trained workforce posed the greatest hurdle to doing business in South Africa. China and India ranked lower than South Africa, at 49 and 50, respectively, due to institutional weaknesses (a category that includes judicial independence, property rights and government favoritism). WEF rankings are drawn from publicly available data as well as the results from a survey of 11,000 business leaders in 117 countries. Source: Business Day, September 29.

OIL PRICES AND RAND IMPACT INFLATION TARGET

¶10. Henry Flint, head of global markets research at Standard Bank, highlighted the relationship between oil prices, rand/dollar exchange rates and inflation targeted by the South African Reserve Bank. Flint's model suggests that CPIX could rise to over 7%, if oil prices remained at $70 per barrel and the rand/dollar exchange rate averaged 6.4 over a year. If oil prices remained at $50 per barrel and the exchange rate averaged no higher than 6.6 rands per dollar for a year, then the CPIX 3% to 6% targeted range would still be met. In the year to date, the rand has averaged R6.31 rands per dollar and the oil price averaged $54.30 a barrel; however, in the past two months oil prices have averaged $63.80. At $60 per barrel and the rand/dollar exchange rate averaging 6.4, inflation should be above the 6% upper range. Flint expects a weakening dollar, high commodity prices, and South Africa to attract more emerging market investments as support of continual rand strength. Source: Business Report, September 29.

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